Natural hedge theory – not just for the birds

Rather than storing grain, many farmers would be better off emptying the shed and paying off bills, says Jeremy Cole.

Shock and awe. No, not another pyrotechnic expression of overwhelming power and vulgarity for the people back in the USA, but the effect on farmers here of rapid falls in grain prices and better than expected yields.

Every piece of information coming in – from government or private sources – again reiterates the fact that supply from this harvest is exceeding demand despite last year's wet autumn and this year's dry spring. This has been the situation ever since the first production estimates 10 months ago. Commodity traders are selling and increasing their sold, short, positions in the futures markets. They feel that the market is overvalued.

The USDA was forced to complete a "special crop survey" when US traders demanded a recount after refusing to believe previous acreage estimates regarding the amount of corn drilled.

But higher yields will mean high supplies whatever the exact acreage. Less corn would by inference mean more soya acres, which were up anyway, and further inflate supplies this season.

Back in Blighty, wheat prices have slipped to £82-85/tonne ex-farm harvest, having fallen by £15 or 14% in a month. The minimum £120 Standard of Living Line (SOLL) is looking like a pipe dream now.

Relative Index Charts (RI) are now below their acceptable trading level, as they were in mid-December, when the market was on its knees. This indicates that the market should rise in the near future, but by how much? Another £30 rise, like the previous post-Christmas rally would be good.

Values have fallen so far now that the downside risk is low. With that and harvest firing on three cylinders, due to rain interruptions, little will be sold in the near future. This is similar to last year, but from a lower base, when prices fell £25 in two weeks.

But it is time to lift up your heads and take stock. There has been the opportunity to achieve £150/t November 09 and several chances for £125. But we are where we are.

Due to the fact wheat prices and yields are negatively correlated, high yields mean low prices. So total revenue will be almost constant. This perfect "natural hedge" means that if one goes down, the other compensates.

Those who never sell until the harvest tonnage is in the barn must believe in Natural Hedge Theory. Indeed, they rely on it to stay in business. Those who set budgets for yield and price then lock into prices at or above their minimum acceptable level, their SOLL, regardless of selling date, benefit from a guaranteed margin on their sales.

They are only risking the percentage they dare not sell – say 25 or 30%. So even if the market then collapses, it is only a small percentage that drags down the average price. A £40 drop is only an average £10 drop if only 25% is left unsold.

To benefit from a future potential rise a hedge can be attached to all or some smaller percentage of the sold tonnage. This creates an acceptable minimum priced contract and allows the upside to be gained, a bonus. The level of cover taken depends on your own view of the probability of the market rising and your view of how much you wish to spend on achieving a potential future gain versus the lower revenue received if it doesn't.

With the market perceived now as really low, and below the cost of production, it is likely there will be very little sold, unless cash or space is an issue. Farmers will hope the market will rise.

Only 30% of the 14.5mt crop has been sold to date and 80% has to be moved by Christmas, as it always is. This means 7m tonnes must be sold between September and Dec period, some 54,000t each day. But the grain trade can't absorb that volume.

I hope the market will rise a little but fear it may not. The best price of the season, give or take 10% from now on, may be now, believe it or not, so storing will again be futile. My advice is to take the money, empty the shed, pay off bills and hope the Natural Hedge helps. Next year's harvest is on its way, so look at the forward prices and lock into a margin before it's drilled.

Jeremy Cole, Bsc Agri Econ (Reading), runs Agricole – an independent grain brokering and marketing service for farmers. For a weekly grain market report, call 01954 719452 or visit www.agricole.co.uk

FRIMSTONE *Ltd*

offer a large range of quality building Aggregates, Roadstone, Carrstone, Limestone and Chalk materials at trade prices delivered in bulk. We are cash purchasers of any surplus concrete areas, airfields or yards etc throughout East Anglia.

Phone 01366 388900

Fax 01366 388901

for a competitive quote